

the price caps for Category I and Category II services. For GTEC, the suspension of the formula will apply to calendar years 1997 and 1998. For Pacific, the suspension will apply to 1996, 1997, and 1998.

This action neither contracts nor expands pricing flexibility. This freeze on the price cap essentially freezes Category I rates (except for changes through the application process) for which LECs now have no pricing flexibility. Our decision today grants no more pricing flexibility for Category I services. The freeze we adopt today fixes the price cap on Category II services (except for changes through the application process), but in no way limits a LEC's ability to change Category II prices between the price cap and the price floor. The general issue of appropriate pricing flexibility is under consideration elsewhere.

We do not address "Z" factors here. We leave the final disposition of this issue to Phase II of this proceeding.

The freeze on the price cap for Category I and Category II services that we adopt today continues our philosophy of relaxing regulation as competition increases. We note that the suspension of the price cap formula effectively reduces the productivity rate to the rate of inflation. Our framework continues to allow the LECs flexibility to reduce rates within

the cap and floor for Category II services. The continuation of this price cap framework via the freeze on the price cap also provides security for California's consumers of telecommunications services. Fair disclosure, however, requires that we once again note that LECs continue to be permitted to change their rates -- both up and down -- between the price caps and price floors for Category II services by filing advice letters⁹⁹ We do not anticipate reviewing these price caps before three years have passed.¹⁰⁰ Pricing flexibility, however, is an issue in the local competition proceeding, and nothing we do here should be interpreted as prejudging the outcome of that proceeding.¹⁰¹

⁹⁹ D.94-09-065 at 286.

¹⁰⁰ If Pacific and GTEC wish to propose to raise their rate above the price caps they may do so by formal application.

¹⁰¹ R.95-04-043/I.95-04-044.

The Financial Impact of The Regulatory Program

The NRF framework requires a review of the financial impact of the regulatory program.

Pacific's witness Evans testified as to the damaging effect of the price cap formula upon the finances of the company.¹⁰²

DRA, AT&T, CCTA, and TURN emphatically contest the LECs' claims of deteriorating financial performance as exaggerated and not primarily the result of the price cap mechanism.

Reviewing Pacific's and GTEC's NRF monitoring reports, DRA notes that when compared with total company operating revenues for January to June 1994, Pacific's January to June 1995 total company operating revenues have declined by approximately 2.3 percent, or \$200 million annually. Similarly, it appears that GTEC's total company operating revenues for January to June 1995 have decreased approximately 5% from their level for January

¹⁰² Exhibit 29 at 1, 6 and 16.

to June 1994. The Proposed Decision notes that for GTEC, June 1995 total company operating revenues actually exceeded June 1994 total company operating revenues.¹⁰³ One month's data, however, is much less meaningful than the long term negative trend.

Generally, Pacific's and GTEC's intrastate rates of return have met or exceeded the market-based rate of return.

Actual Intrastate Rate of Return (in percents):

<u>Year</u>	<u>P*B ROR</u>	<u>GTEC ROR</u>	<u>Adopted Market ROR</u>
1990	12.39	13.41	11.50
1991	11.31	14.09	11.50
1992	12.03	14.20	11.50
1993	9.51	13.28	11.50
1994	11.17	12.33	10.00, (10.50 for GTEC)

Source: Exhibit 60

GTEC exceeded the market-based rate of return for every year between 1990 and 1993. Had GTEC not entered into a settlement agreement, the company would have exceeded the return that would have been considered for it in 1994. Pacific's intrastate rate of return was close to or exceeded the market-

¹⁰³ PD-01-014 and GD-04-00, respectively. Monthly operating revenues for Pacific for January 1994 through July 1995 and for GTEC for January 1994 through June 1995. (DRA Brief at 14.)

based rate of return for every year from 1990 through 1994 with the exception of 1993. We wish that such a trend would and could continue. Unfortunately, the most recent Commission data on monthly RORs for 1995¹⁰⁴ shows a starkly different financial picture:

<u>Month</u> <u>ROR</u>	<u>P*B ROR</u>	<u>GTEC</u>
Jan	11.45	7.875
Feb	8.89	11.080
Mar	6.24	9.963
Apr	8.99	8.050
May	11.27	3.008
Jun	6.59	7.329
Jul		14.053
<u>Aug</u>	<u> </u>	<u>7.466</u>
Y-T-D	8.92	8.602

Sources: P.O. 01-27; G.O. 04-00

How much of Pacific's financial situation is attributable to the implementation of NRF? The evidentiary record does not support the view that the majority of the decline in the company's revenues is the result of NRF; but neither does it show that NRF has not been a major contributing factor in the declining financial positions of the LECs.

¹⁰⁴ The adopted ROR for 1995 is 10.00.

The S.G. Warburg Research Statistical Summary¹⁰⁵ tabulated Pacific's revenues from 1984 through 1994. Pacific witness Evans presented a list of revenues from 1984 through 1989.¹⁰⁶ Both exhibits show revenues declining from 1986-1987, from 1988-1989, from 1989-1990 and from 1990-1991. The only post-NRF year in which revenues declined was the first year of the operation of NRF. Exhibit 16, measuring the total return indices, price change plus reinvested dividends for the RBOCs, indicates that since 1984, Pacific, as the subsidiary of Pacific Telesis Group, has placed in the middle of the RBOCs/Regional Holding Companies (RHC) in stock performance. Pacific's return on equity for the 12-month period ending June 30, 1995 was commensurate with other RHCs.¹⁰⁷ Moreover, according to Exhibit 65,¹⁰⁸ a May 1995 Salomon Brothers report, Pacific Telesis'

¹⁰⁵ Exhibit 41 at 20.

¹⁰⁶ Exhibit 45, Bates Stamp 000664.

¹⁰⁷ Exhibit 58 at 2-6.

¹⁰⁸ *Regional Bell Operating Companies (RBOCs) -- Creeping Competition in Local Service Implies Shrinking Margins and Market Share for RBOCs* at 3.

dividend yield is 8.1%, the highest¹⁰⁹ of the RBOCs. The report views Pacific's payout as too high and not sustainable.¹¹⁰ Similarly Duff Phelps has reduced Pacific's credit rating.¹¹¹

A further review of the record sustains both Salomon Brothers' judgment, and our own concerns that revenue contraction erodes Pacific's financial situation. The record shows that for 1984-1989, Pacific's revenues on a normalized basis grew at a 2.8% compound annual growth rate (CAGR), while in the 1990-1994 period under the GDPPI minus "X" form of regulation, revenues grew at only a .2% CAGR.¹¹² Moreover, a comparison of net income growth conveys an even gloomier picture. The record shows Pacific has had no positive net income growth over the last five years. While net income for the 1984-1989 time period grew at 7.2% CAGR, net income for the 1990-1994 period under the GDPPI minus "X" form of price cap regulation declined at a 2.2% CAGR.¹¹³

Pacific maintains that the Telesis wireless spinoff is irrelevant to this proceeding. However, as TURN suggests, a

¹⁰⁹ Second highest is NYNEX at 5.7%.

¹¹⁰ Confusingly, the Salomon report often interchanges its discussion of RBOCs and RHCs.

¹¹¹ Mr. Evans (for Pacific) Exhibit 29 at 14.

¹¹² Mr. Evans (for Pacific) Exh. 29, Att, p. 10.

¹¹³ Id. at 12-13.

careful examination of the Pacific Exhibit 29¹¹⁴ comparison of CAGRs of the LEC and six RBOCs between 1984-1994 and Exhibit 42 challenge the company's assertion. The effect of this spinoff by Pacific Telesis, not Pacific Bell, obviously complicates the financial market's assessment of the holding company, but it has no direct affect on Pacific Bell's revenues. Clearly the spinoff by the parent holding company does not preclude the modification of regulation for Pacific Bell, the regulated subsidiary.

While we appreciate the cumulative effect of the price cap formula upon the LECs, it is clear that the state's economy has also had a definite impact on revenues. Forecasts predict that California can expect to outperform the nation in the next few years¹¹⁵ and we hope this is the case. Testimony indicates that Pacific will continue to realize efficiency gains,¹¹⁶ but based on ample evidence in the record, we find it unrealistic to believe that Pacific can continue to realize additional efficiency gains at current levels. Pacific has already achieved the easy gains by becoming highly efficient.¹¹⁷ Additional

¹¹⁴ Exhibit 29 at 11: Table 2 - "Telephone Company Revenue \$M".

¹¹⁵ Exhibit 58 at 2-6.

¹¹⁶ Exhibit 29 at 9; 4 RT 613, line 17 to 614, line 5.

¹¹⁷ Mr. Evans (for Pacific) Exh. 29, pp. 5-9.

efficiencies are more difficult to achieve, as pointed out by numerous expert witnesses.¹¹⁸ We conclude that Pacific's declining revenues are the result of numerous factors, with the effects of NRF particularly significant.

As a policy matter, the Proposed Decision attached inadequate weight to the consequences of the Price Cap formula on the financial markets. The forced reductions lock the LECs into a constricting internal cost constraint. The record shows that Pacific had 13,915 fewer employees at the end of 1994 than at the beginning of incentive regulation -- a reduction of over 20%.¹¹⁹ Although the record on this point is not well developed, the comments of the Communications workers of America make us wonder whether such reductions in labor force continue without threatening the state's infrastructuring of skilled workers.

These same automatic price reductions can present an obstacle to the LECs in the capital markets and the ability of LECs to finance infrastructure. Financing for infrastructure can be hindered when regulation creates an automatically declining

¹¹⁸ Id. at 7-9; Exh. 41, p. 51; Dr. Schmalensee (for Pacific) Exh. 1. Att. 1, p. 11; Dr. Christensen (for Pacific) Exh. 6, Att. pp. 23-25, 29.

¹¹⁹ Mr. Evans (for Pacific) Exh. 29, att., pp. 8-9; 3 TR. 559

revenue stream. Regulators know well that revenue trajections are key to financial ratings.

In the last review, we undertook what appears to be the controversial examination and determination of the appropriate productivity factor. D.94-06-011 reaffirms our Phase II resolution "to look to a target which is a differential productivity adjustment supported by information outside the utility's control with a 'stretch' added."¹²⁰ Although the prospect of the BLS's long-promised index continues to hold some fascination for the Commission, national fiscal reality indicates that it is likely our efforts to open telecommunications markets have a good chance of succeeding before this long awaited study becomes a reality. To guide our policy deliberations, we must look elsewhere for one or several studies "that capture the essential parameters of the methodology that we have held to be reasonable."¹²¹ Pacific presented Dr. Christensen's direct testimony¹²² to satisfy our request.

Among other determinants, the compressed schedule of this phase of the proceeding complicated the valuation of Dr. Christensen's study. The Commission would have greatly

¹²⁰ D.94-06-011, mimeo. at 37.

¹²¹ Id.

¹²² Dr. Christensen (for Pacific), Exhibit 6.

preferred the study to have been accessible for validation by all parties. Instead, the Christensen study appears before us as a Pacific or LEC study. Thus, assigning the proper weight to this study requires careful consideration.

Based on the results of his study, Dr. Christensen recommends a productivity or "X" factor of 2.1%. As Pacific emphasizes, Dr. Christensen's short-term study results are consistent with the long-term telephone industry TFP differential.¹²³

Pacific and GTEC maintain that a 2% "X" factor will continue to pose a tough challenge. This, notwithstanding the fact, that adoption of the LECs' modified price cap formula will mean for California ratepayers approximately a 1%¹²⁴ increase in their telephone rates compounded annually: totaling \$55 million, \$110 million, \$165 million, and \$330 million, respectively, from 1996 to 1998.

Pacific and GTEC contend that the LECs have not received the promised rewards of NRF. During the six years of the NRF, the companies have either met or exceeded the adopted reasonable rate of return. None of the LECs' experts assert that

¹²³ Pacific Brief at 31.

¹²⁴ Assuming a 1% inflation factor. Pacific Brief at 41, footnote 126.

the companies would have fared better under rate-of-return regulation.¹²⁵ Retrospectively, the price cap regulation appears to have produced reasonable rates and earnings. Prospectively, our monitoring reports containing the ROR's for 1995 indicate that these days of solid earnings have come to an end. We suspect that the simple productivity gains realized in the initial years of price cap regulation have come to an end.

The Proposed Decision did not accept Dr. Christensen's study on TFP differential. The Proposed Decision cited a series of factors that led to its determination. The PD stated that:

During cross-examination,¹²⁶ it was revealed that Dr. Christensen was unable to explain the methodology that was used to gather the data upon which his results depend and he was unable to explain how the errors seemingly corrected in his January 1995 update were discovered or corrected.¹²⁷ CCLTC notes that the magnitude of a number of the unexplained errors is substantial.¹²⁸ Dr. Christensen also testified that he had no knowledge of how certain significant costs were calculated by the LECs. He was unaware

¹²⁵ 2 RT 264 and Exhibit 35 at 5.

¹²⁶ 2 RT 200-239.

¹²⁷ Exhibit 8.

¹²⁸ CCLTC Brief at 6-13.

of whether or not gross inconsistencies exist with the methodologies used to gather data for his study. GTEC's witness Dr. Duncan stated that if gross inconsistencies occurred in the calculation methods: "...okay, you're going to run into problems."¹²⁹

Finally, the Proposed Decision¹³⁰ notes that Dr. Christensen admitted that he did not know precisely how an integral component of his TFP calculation, the "Telephone Plant Indexes" (TPIs),¹³¹ were computed¹³² and that he could not supply any work papers behind the TPI figures that were provided to him by the LECs.¹³³

¹²⁹ 5 RT 792.

¹³⁰ Proposed Decision, p. 41.

¹³¹ TPIs, developed by the individual Regional Bells and the other LECs, reflect changes in the cost of key capital input factors, like central office equipment, wire and cable, and transmission equipment (among others). Unlike standard, published indices like the GDPPI and the Consumer Price Index, the TPIs are not equalized price series published by a government agency or other independent source. Rather, they are prepared individually by each RBOC on a highly proprietary basis. CCLTC Brief at 10.

¹³² 2 RT 197-198.

¹³³ Exhibit 8.

Although these issues led the PD to conclude that Dr. Christensen's study was not a reasonable substitute for the BLS index, we believe that the PD failed to assess properly the valuable information provided by Dr. Christensen in his testimony. First, we note that Dr. Christensen testified that the methodology used to gather data was based upon specifications provided by the Bureau of Labor Statistics.¹³⁴ Dr. Christensen testified that the data provided to him were provided to the BLS for use in the long awaited BLS study of LEC productivity growth.¹³⁵ Second, although the PD notes Dr. Christensen's inability to explain how the errors were discovered or updated, the vast majority of study data were verified with Form M data formally filed with the FCC.¹³⁶ Moreover, the Proposed Decision errs in misinterpretation CCLTC's assertion that the number of errors are substantial as a characterization that the study was substantially in error. Even if the number of errors detected and corrected was large, the overall effect of these error

¹³⁴ Dr. Christensen (for Pacific) 2 Tr. 199.

¹³⁵ Dr. Christensen (for Pacific) 2 Tr. 193.

¹³⁶ Dr. Christensen (for Pacific) 2 Tr. 196-7

corrections and changes was minimal, resulting in an adjustment of two tenths of one percent in the LEC TFP.¹³⁷ Thus, the core value of this study remains.

We note that Dr. Christensen was the only party to undertake a productivity study. Moreover, Dr. Christensen is a nationally recognized expert in productivity analysis with a substantial record of original research and publications in journals subject to peer review.¹³⁸ Other parties used his study as a starting point from which they then deviated. The simple updating of statistics that Christensen performed is a routine professional practice. In addition, the lack of "purity" cited in the PD would virtually disqualify all empirical studies from use in our proceedings. Data problems are common in all applied research and do not, by themselves, disqualify a study.

We also note that Dr. Christensen lists five other studies of TFP differential of the telecommunications industry. Those studies have results of the TFP differential for the telecommunications industry that range from a low of 1.85% to a high of 2.2%. The study periods for the five other studies are long-term (all examine periods in excess of 25 years).

¹³⁷ Dr. Christensen (for Pacific) Exh. 7, Att., pp. 6-7; 2 Tr. 238.

¹³⁸ Ex. 6, App. 4 (Resume).

Dr. Christensen studied the period from 1985 to 1993. While we are not convinced that a point estimate of a 2.1% TFP figure recommended by Dr. Christensen is the single "correct" number, the consistency of this finding with the range of findings cited above causes us to conclude that the "correct" TFP amount lies in a range between 1.8 and 2.6.

Dr. Selwyn's recommendation of a 5.7% "X" factor proposal has problems. His recommended value of 5.7% is comprised of three parts. A 2.6% amount to reflect TFP, another 2.6% amount to reflect the input growth factor differential, and a 0.5% "stretch factor". The 2.6% TFP amount is based upon Dr. Christensen's earlier study. We differ from the PD in our assessment of Dr. Selwyn's testimony. Once again, we find a TFP that falls within the range of 1.8% to 2.6%. We do not, however, fully accept Dr. Selwyn's analysis. Our previous discussion of the impacts of the "X" factor make it clear that a "stretch" factor is no longer appropriate public policy. Finally, although we find the arguments of Dr. Selwyn on "input price differentials" theoretically interesting, we conclude that there is no basis for concluding that an empirical input price differential will exist in the next three years, or that it exists today.

Indeed, the record contains substantial evidence that the input price differential between the telecommunications industry and the U.S. economy is zero. Dr. Christensen provided data on input price growth for the telephone industry and the overall economy for the years 1949 to 1992,¹³⁹ and his analysis demonstrated that input prices for the telephone industry and the rest of the economy grew at virtually the same rate, with only a 0.05% difference.¹⁴⁰ Further, Dr. Christensen testified that although Dr. Selwyn shows an input price differential for the 1984-1992 period, the volatility of that period is so great that the observed differences are not statistically distinguishable from a difference of zero.¹⁴¹ This same conclusion is reached by Dr. Schmalensee and Dr. Duncan.¹⁴² Based on this record, there is no basis to conclude that the input price differential is different from zero. This result arises because the average of a highly volatile short-term input price differential provides a poor basis to predict future input price behavior.

Based in the totality of the evidence in the record, we conclude that a policy of suspending the application of the price cap formula obviates the need to designate one productivity

¹³⁹ Dr. Christensen (for Pacific) Exh. 6, Att., pp. 17-18.

¹⁴⁰ Dr. Christensen (for Pacific) Exh. 7, Att., pp. 13-15.

¹⁴¹ Id. at 8.

¹⁴² Dr. Schmalensee (for Pacific) Exh 2, Att. 1, p. 11; Dr. Duncan (for GTEC) Exh. 37, pp. 8-10.

factor as the productivity factor. Our suspension of the formula produces reasonable rates to Californians, and is consistent with the range of productivity estimates presented to us in the record of this proceeding. We note that the range of total productivity factors included in this record was from 1.8 to 2.6. The suspension of the price cap formula effectively equates the "X" factor with GDPPI. This year, the GDPPI is 2.9%, close to the range of productivity factors found in this record. We further reject a productivity factor of 5.0% because it is outdated, no longer reflects today's markets and prices, and is inconsistent with the record. We further find that any use of a price-cap formula that includes an "X" factor of 5.0% is an unreasonable policy. Should the Commission ever intend to end the suspension in the use of this particular price cap formula, a full and new investigation of the appropriate "X" factor would be required.

B. Should the Price Cap Formula be Applied to All Category I and Category II Services, or Solely to Category I Services?

Positions of the Parties

Pacific's primary position is that the price cap formula should be eliminated completely. In the alternative, Pacific recommends that the price cap formula, reflecting a productivity factor of no more than approximately 2%, should

apply only to Category I services. Pacific states that the concept of Category II as a price category is that it allows prices to fluctuate within a price range in reaction to competition. The company argues that productivity gains in a competitive market will flow through to customers through price, quality, service, or technology improvements; therefore the automatic, across-the-board adjustments to price caps and floors for Category II services does not make sense in the competitive environment that Pacific faces.

As stated above, GTEC proposes that the price cap formula be applied solely to Category I services. GTEC witness McCallion argues that the present price cap formulation requires across-the-board price reductions for all Category I services and also, effectively, for Category II services regardless of the margins or competitive pressures associated with any particular services.¹⁴³ He maintains that despite the "potentially selective and changing nature of competitive challenges," it would be "inappropriate" to continue to apply a productivity offset to services that are opened to competition. McCallion submits that reducing the rates of customer services priced near or below cost

¹⁴³ Exhibit 27 at 11.

through a productivity offset is counterproductive and not characteristic of a competitive market environment. CTC-California agrees with Pacific and GTEC that opening local exchange markets to competition justifies elimination of the formula for Category II services.

DRA, AT&T, TURN and DOD/FEA contend that the GDPPI minus "X" factor should continue to be applied to both Category I and Category II services until the many uncertainties, including but not limited to the local competition proceeding, universal service, OANAD, the categorization of services and the determination of effective competition, are resolved. MCI recommends that the current price cap formula be maintained as long the NRF-regulated LECs maintain significant market power. DRA, CCTA and AT&T assert that the Commission provides a vehicle for both Pacific and GTEC to recategorize services from Category II to Category III, if they believe that effective competition exists in those services. DRA and TURN note that since the majority of Category II services are only partially competitive while the remainder are discretionary, the continued application of the price cap formula to Category II services will protect the Category II services' customers that have no competitive alternative.

Discussion

The common denominator of all the arguments received is that as competition increases, regulation should become more "relaxed." We substantially agree with the analysis of and identification of regulatory issues concerning our current use of regulatory categories to limit pricing flexibility and to determine whether to apply a price cap to the rates for a particular service. We agree, as does the PD, with the assertion that under our current regulatory scheme the procedure to achieve more relaxed regulation is to move a service into a different Category (i.e. a Category I service moved into either Category II or III, or a Category II service moved into Category III). As a number of the parties point out, the NRF framework is flexible by design. If a particular service is facing more competition, the LEC is entitled to request recategorization. The rarity with which this occurs and the length of the subsequent regulatory process, raises our concern over whether the regulatory program is meeting its promise of flexibility.

In the face of the current level of competition -- uneven yet clearly increasing -- we suspect that our original measurement of the LECs' services reflects the industry of six years ago. We know that the industry has not remained static. The Commission would have welcomed from Pacific and GTEC a

substantive evaluation of the recategorization process, such as whether its assessment of incumbent market power appropriately reflects the competitive forces of today, and how market power might be more accurately assessed as local exchange competition commences and grows. We cannot disagree that the LECs, in their request for further regulatory relaxation, have made a showing substantially less focused and complete than that which we required of AT&T and found in D.93-02-010.¹⁴⁴ For this reason, we cannot grant Pacific and GTEC the regulatory flexibility enjoyed by AT&T. We therefore take the more modest step of freezing the cap on prices for Category I and Category II services.

When Category II was established in D.89-10-031, the Commission recognized that the LEC "retains significant (though perhaps declining) market power."¹⁴⁵ Although Category II

¹⁴⁴ The Commission examined eight factors: 1) determination of the relevant market, 2) market share, 3) AT&T-C and other IXC earnings, 4) ownership of facilities by other IXCs, 5) ease of market entry and exit, 6) individual carriers' size and growth potential, 7) equal access and other technical factors, and 8) service options and customer satisfaction. D.93-02-010 at 25; AT&T Brief at 20, footnote 8. We note that these were factors relevant to AT&T's request to be regulated as a nondominant interexchange carrier. We are here considering only a modification of price cap regulation, not a dismantling of current regulation.

¹⁴⁵ 33 CPUC 2d at 125.

services continue to be, as originally defined, discretionary or partially competitive, the level of competition has indeed risen for some services. The envisioned decline in market power has occurred for some services and most likely will continue to drop for services in Category II. While the LECs retain significant market power, the record reflects that the level of competition for Category II services has risen most notably in intraLATA toll.

Still as DRA, TURN, and AT&T note, not all Category II services face the same level of competition. The LECs urge that we replace consideration of whether effective competition has developed with faith in the marketplace guided by imminent competition. We do not adopt the LECs' suggestion. As we stated above, we are not convinced by this evidentiary record that the elimination of the cap on prices for all Category II services would be appropriate before it is clearer that such action will not impede competition or harm ratepayers. Nevertheless, the Commission is concerned that the pricing flexibility enjoyed by several of the Category II services has been constrained over the years because of the price cap treatment on price ceilings versus price floors. We have already stated in our local competition proceeding that open markets will clearly require greater pricing flexibility than we currently allow. We desire justifiable

solutions to this dilemma, and by subsequent ALJ ruling will clarify which proceeding will offer the most timely consideration of these issues.

Service quality will be addressed in Phase II of this proceeding. CCTA's proposal to modify the price cap formula with the addition of a Q factor cannot be implemented without a continued application of the price cap formula that we suspend in this decision, we reject this approach. MCI's "True Price Cap" proposal looks to the resolution of a number of cost issues appropriate to the OANAD proceeding. Consequently, we are not persuaded that it would be reasonable to adopt such a recommendation before the OANAD proceeding is concluded.

C. Should Implementation of NRF Modifications be Ordered in Stages, Contingent on Achieving Milestones?

Positions of the Parties

Pacific and GTEC argue that there should be no milestones prescribed to effect NRF modifications. Pacific declares that "[t]rying to level the playing field in this proceeding by manipulating GDPPI minus "X" cannot produce an evenhanded resolution."¹⁴⁶ It contends that the productivity

¹⁴⁶ Pacific Brief at 38.

factor was designed to provide incentives for efficiency, not to reduce any "alleged barriers to entry." GTEC maintains that the LEC competitors are using this proceeding as a device to hamper the LECs' ability to compete in the marketplace. GTEC advises that milestones should not be set to provide competitors with a competitive advantage.¹⁴⁷

DRA proposes linking NRF relief to the achievement of milestones. It suggests that after the projected implementation of interim facilities-based local competition on January 1, 1996, and the projected adoption and implementation of interim rules for bundled resale-based competition on March 1, 1996, the Commission should eliminate the 50 basis point stretch component of the "X" factor. DRA recommends that after the January 1, 1997, adoption and implementation of the final rules for local competition and the resolution of other competitive and universal service issues, the "Commission should monitor the local exchange market to gauge the emergence of effective competition."¹⁴⁸ It calls for a third triennial review in 1998, with further modification or elimination of the price cap mechanism, if the Commission explicitly finds that effective local competition exists.

¹⁴⁷ GTEC Brief at 44.

¹⁴⁸ DRA Brief at 4.